

*Sent via electronic filing*

November 15, 2002

Hon. Magalie Roman Salas, Secretary  
Federal Energy Regulatory Commission  
888 First Street, NE, Room 1-A  
Washington, DC 20426

Re: Remediating Undue Discrimination  
through Open Access Transmission Service  
and Standard Electricity Market Design  
Docket No. RM01-12-000

Dear Ms. Salas:

For filing in the above referenced docket, please find attached comments on behalf of the Kentucky Public Service Commission.

Sincerely,

Deborah T. Eversole, Esq.  
Richard Raff, Esq.  
Kentucky Public Service Commission  
211 Sower Boulevard  
P.O. Box 615  
Frankfort, KY 40601  
502-564-3940

Enclosure

**UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION**

<b>Remedying Undue Discrimination</b>	)	
<b>through Open Access Transmission Service</b>	)	<b>Docket No. RM01-12-000</b>
<b>and Standard Electricity Market Design</b>	)	
	)	

**INITIAL COMMENTS OF THE  
KENTUCKY PUBLIC SERVICE COMMISSION**

The Kentucky Public Service Commission (“Kentucky PSC”) respectfully submits these comments to FERC in response to its Notice of Proposed Rulemaking to implement a standard market design for all electricity markets nationwide (the “SMD NOPR”). This document is to place on record the serious concerns of the Kentucky PSC regarding the jurisdictional implications of the SMD NOPR, as well as the adverse consequences for Kentucky’s electricity ratepayers if the rules as proposed are adopted.

Though the comment deadline for several issues treated in the SMD NOPR has been extended to January 10, 2003, we include here our concerns regarding all issues. We will supplement our comments as more details become available through FERC’s technical conferences.

All comments of communications concerning these comments should be addressed to:

Deborah T. Eversole, Esq.  
Richard Raff, Esq.  
Kentucky Public Service Commission  
211 Sower Boulevard  
P.O. Box 615  
Frankfort, KY 40601  
502-564-3940

and

Barbara S. Jost, Esq.  
Richard M. Lorenzo, Esq.  
Huber Lawrence & Abell  
1001 G Street, N.W.  
Washington, D.C. 20001  
202-737-3880

### **EXECUTIVE SUMMARY**

The Kentucky Public Service Commission has serious concerns regarding the jurisdictional implications of the SMD NOPR, as well as the adverse consequences for Kentucky's electricity ratepayers if the rules as proposed are adopted.

The Commonwealth of Kentucky has the lowest average electricity costs in the nation. In addition, our electricity service is highly reliable. FERC seeks to force fundamental changes to the way Kentucky's utilities operate without any probative evidence that there is a need for such changes, and without any showing that customers served by these utilities will see significant benefit from them. Such dramatic changes are certain to undercut the very foundation of the reliable and low-cost electricity service that Kentucky customers enjoy.

The Kentucky PSC's primary concerns regarding the SMD NOPR are as follows.

- The SMD NOPR, intended to provide financial stability to electricity markets, will destabilize retail markets in rate-regulated states such as Kentucky.
- Though the Kentucky PSC recognizes the importance of creating certainty and stability, the SMD NOPR does not achieve those goals.
- The SMD NOPR would unfairly burden Kentucky's retail ratepayers with costs properly borne by those who will benefit from the SMD NOPR's

implementation.

- Absent a thorough cost benefit analysis demonstrating benefits to all, FERC should not implement standard market design.
- The new congestion management system proposed in the SMD NOPR will be costly to implement, and may not preserve the vested rights of those who have paid for the existing systems.
- Those who have paid the embedded costs of transmission should retain the right to all of that transmission capacity, and the SMD NOPR does not so provide.
- FERC's proposal for a federally mandated generation requirement is not only unlawful, it is bad regulatory policy, and it should be removed from the SMD NOPR.
- The SMD NOPR would relegate the states to merely advisory roles, interfering with their exercise of the police power and depriving the general public of a meaningful voice.
- Any market monitoring mechanism must provide the monitor with meaningful authority, ensure independence, and actively involve state regulators.
- FERC lacks jurisdiction to implement large segments of the SMD NOPR.

Accordingly, the Kentucky PSC urges FERC to abandon its "one-size-fits-all" approach and the SMD NOPR as currently constituted.

## **BACKGROUND**

The Commonwealth of Kentucky has the lowest average electricity costs in the nation. In addition, our electricity service is highly reliable. Afflictions experienced in electricity markets elsewhere in the nation – brownouts, rolling blackouts, price spikes, market meltdowns – have not occurred in Kentucky; nor will they, under the present regulatory environment. FERC devotes 80 pages of the SMD NOPR, almost one third of the text of the entire document, to explaining why this new rule is required to “to achieve the goals of non-discriminatory transmission access and competition in electric markets.”<sup>1</sup> Having read this document closely, and having listened to FERC representatives at the many outreach sessions undertaken by FERC and its staff,<sup>2</sup> the Kentucky PSC remains unconvinced that there is anything wrong with the retail electricity markets in Kentucky.

FERC seeks to force fundamental changes to the way Kentucky’s utilities operate without any probative evidence that there is a need for such changes, and without any showing that customers served by these utilities will see significant benefit from them. Certainly the first goal of all regulation should be to do no harm. Yet, FERC seeks to require jurisdictional utilities in Kentucky to modify substantially the way they operate, to turn over control of their transmission systems to unaffiliated third parties and to give third parties in neighboring higher cost states control over the further expansion and development of essential elements of the Kentucky electric grid, all without any showing that such actions can possibly enhance the reliability or reduce the cost of power to the citizens of Kentucky. Such dramatic changes are certain to undercut the very foundation

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<sup>1</sup> NOPR, Paragraph 22.

<sup>2</sup> In particular, the Kentucky PSC appreciates the participation and attendance of both Chairman Wood and Commissioner Breathitt, together with other Commission Staff representatives, at Governor Patton’s Conference on SMD, entitled “Standard Market Design: A National Discussion with Energy Policy Decision Makers,” held October 9 and 10, 2002, in Louisville, Kentucky.

of the reliable and low-cost electricity service that Kentucky customers enjoy.

The Kentucky PSC respectfully suggests that FERC's SMD NOPR reflects an incorrect policy determination - - that competition in electricity markets, for the sake of competition, necessarily benefits everyone. Moreover, FERC's legal authority to impose critical elements of this rule is highly suspect. Accordingly, the Kentucky PSC urges FERC to abandon its "one-size-fits-all" approach and the SMD NOPR as currently constituted. If it insists on going forward, at the very least, FERC must focus on those states that have high cost power and are experiencing the market dysfunctions this rule seeks to remedy. This approach will allow utilities in Kentucky and other non-restructured states to continue operating under the existing regulatory model. This approach will further ensure that such utilities can continue to provide reliable electricity service and cost-based rates to the citizens of those states that have not chosen electric restructuring.

### **COMMENTS**

**I. The SMD NOPR, intended to provide financial stability to electricity markets, will destabilize retail markets in rate-regulated states such as Kentucky.**

Kentucky's electricity industry is healthy and thriving. The regulatory scheme governing Kentucky's utilities, codified in Chapter 278 of the Kentucky Revised Statutes, has allowed the Kentucky PSC and Kentucky's regulated utilities to develop policies that ensure a sufficient level of reliable service at reasonable prices. This regulatory compact has worked efficiently and effectively for decades. Specifically, it has fostered a stable regulatory environment that has allowed our utilities to proceed with the long-term capital-intensive investment in generation and transmission facilities necessary to serve

customers throughout the Commonwealth of Kentucky. The result: Kentucky today has undisputed claim to the lowest electricity rates in the nation. However, the impact of the SMD NOPR will be to drive up the price of power in Kentucky and other low cost states while simultaneously reducing the level of reliability for bundled retail customers.

Unregulated energy markets are some of the most volatile commodity markets. It is inexplicable that the NOPR would express apparent shock that “boom-bust” cycles are a characteristic of unregulated energy markets.<sup>3</sup> These cycles are more pronounced in electricity markets than in most others for two major reasons: first, electricity, unlike oil and gas, cannot be economically stored; second, a law of physics requires electricity supply and demand to be in balance at all times.

These boom-bust cycles can be mitigated or hedged by long term-contracts. We have used the “contract” method for decades to ensure that adequate electricity production and transmission capability are available for Kentucky customers. The contract provides a utility with an exclusive service territory in return for an obligation to provide adequate generation and transmission facilities. This contract operates as a matter of law and is codified in Kentucky Revised Statutes Chapter 278. Though the venerable regulatory compact seems to have fallen into disfavor with FERC, it has provided incentives for long-term capital-intensive investments that have resulted in sufficient generation and transmission in Kentucky. It also has provided unquestioned certainty for both our ratepayers and our utilities. It is now ironic to see the regulatory compact mimicked in explicit contracts, such as in “take-or-pay” provisions, even in

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<sup>3</sup> NOPR, Paragraph 473 discusses the need for Generation Adequacy requirements to alleviate the “price swings of the electricity business cycle.”

competitive wholesale markets. However, while these explicit contracts do provide similar hedges against uncertainty, they lack the measure of reasonableness that cost-based rates ensure.

Jonathan Raleigh, a highly regarded utility financial analyst with the firm of Goldman Sachs, recently observed that “the best performing stocks in the utility industry have been those with fully regulated (state) service territories . . . in the mind of investors regulatory change has only hurt companies and investors.”<sup>4</sup> He further notes that the basic concerns of investors include the fact that the proposed SMD replaces “‘constructive’ state regulatory control with an unproven methodology for cost recovery and returns.” The Kentucky PSC shares this perspective.

## **II. Though the Kentucky PSC recognizes the importance of creating certainty and stability, the SMD NOPR does not achieve those goals.**

As a fellow regulatory body, the Kentucky PSC understands the importance of a stable and certain regulatory environment. However, the SMD NOPR is an over-reaction, to put it mildly, to the financial devastation that has recently occurred in some electricity markets. The proposed rules would not only penalize those portions of the nation that do not suffer from the problems that gave rise to the SMD NOPR; they would not even restore financial stability to the areas that have suffered. The SMD NOPR is a dangerous experiment, designed to benefit market players, not retail customers who have built and paid for the nation’s transmission facilities through regulated retail electricity rates for nearly 70 years.

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<sup>4</sup> September 12, 2002 Comments to Kentucky Public Service Commission.



It is appropriate that FERC attempt to establish wholesale market stability. However, implementation of the far-reaching policies described in the SMD NOPR threatens to bring chaos to Kentucky and other stable electricity markets. Rather than rush to judgment,<sup>5</sup> FERC should address individual markets and their problems. For example, FERC has recognized that electricity markets function very differently in the west, with their substantial hydroelectric resources, as compared to the northeast, with their coordinated joint operations and planning under the aegis of tight pools such as the NEPOOL. The fact that electricity markets function differently in different parts of the country is not necessarily a problem, except perhaps for energy traders that stand to benefit financially from strict nationwide standardization. Once specific problems are identified, solutions must be coordinated with the well functioning elements of the marketplace, including those markets where utilities continue to provide traditional bundled services regulated by state commissions. FERC's current attempt to stabilize electricity markets is certain to come at the expense of millions of electricity customers who will receive less reliable services at higher prices. Not only is such a course of action unjust and unreasonable, it is irresponsible.

**III. The NOPR would unfairly burden Kentucky's retail ratepayers with costs properly borne by those who will benefit from the SMD NOPR's implementation.**

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<sup>5</sup> FERC should heed the recent report issued by the United States General Accounting Office (GAO-02-656), issued June 2002, that concluded: "FERC must overcome significant human capital and organizational structure challenges to effectively regulate and oversee the evolving energy marketplace." (Report, p. 5).

It is of paramount importance that the costs associated with SMD be borne by those who benefit. Yet, the rules proposed in the SMD NOPR, if implemented, are certain to unfairly increase the price paid by Kentucky retail ratepayers who would realize little, if any, benefit. Quantifying the expected increase, however, is extremely problematic. One of the major concerns the Kentucky PSC has with the SMD NOPR is the many unanswered questions. These questions create a high level of uncertainty for both regulated electric utilities and for electricity markets themselves. They also make it impossible for us to do any meaningful calculations regarding specific cost shifts due to new SMD policies.

However, the impact of current FERC policies is already taking a toll as retail rates in Kentucky are likely to rise as a result of the tens of millions of dollars in administrative and other costs<sup>6</sup> that MISO incurs annually.<sup>7</sup> Schedule Nos. 10,<sup>8</sup> 16 and 17<sup>9</sup> of the MISO tariff allocate substantial costs to utilities who serve a large portion of

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<sup>6</sup> With an annual operating budget approaching \$70 million, a capital budget of more than \$30 million, and staff of 210 people, MISO is clearly not an inexpensive undertaking. (Information is available in MISO's published 2002 Budget.) Further, the number of employees needed at MISO is projected to grow by an additional 40 people, as a result of fulfilling obligations pursuant to the SMD NOPR. (Information comes from MISO's Advisory Committee Meeting Minutes, August 14, 2002.)

<sup>7</sup> Kentucky ratepayers may similarly incur additional costs as a result of AEP being a member of PJM.

<sup>8</sup> FERC has requested that the United States Court of Appeals for the District of Columbia Circuit remand matters currently on appeal regarding allocation of MISO costs. *See Midwest ISO Transmission Owners v. Federal Energy Regulatory Comm'n*, Case Nos. 02-1121 and 02-1122 (consolidated). The Kentucky PSC is one of the parties to this case. Among the matters there being considered is the issue of a settlement agreement between the Kentucky PSC and MISO that exempts native load customers from the cost adder in Schedule No. 10. FERC refused to approve that settlement agreement, and mandated that all customers, including native load, pay the Schedule No. 10 adder. *See Midwest Independent Transmission System Operator, Inc.*, 97 FERC ¶ 61,033 (2001), *on reh'g*, 98 FERC ¶ 61,141 (2002).

<sup>9</sup> *See* FERC Docket ER02-2595-000. Schedule Nos. 16 and 17 provide for the collection of costs incurred by the Midwest ISO to provide Financial Transmission Rights (FTRs), establish and implement within its footprint day-ahead and real-time energy markets and facilitate the creation of a joint and common market by and

the retail customers in Kentucky. Few of these MISO costs are incurred for the benefit Kentucky's retail load since the functions performed by the RTO neither enhance service reliability nor lower the cost of service to bundled retail customers, particularly those customers served by utilities that own their own generating facilities. RTOs add an unnecessary layer of bureaucracy for which Kentucky customers must pay.

As many as thirty-five states have chosen not to restructure their electricity industry at this time. In some cases, states have taken steps toward restructuring, but have delayed or reversed course when the difficulties experienced in other states became apparent. In other cases, such as in Kentucky, the state has spent much time studying the possible impacts of restructuring, and has determined it is not in the best interest of the state at this time. A 1998 Kentucky Legislative Task Force on Electricity Restructuring found that Kentucky's consumers would only see the price of electricity rise under a restructured environment, and recommended that Kentucky's electricity market remain regulated.<sup>10</sup>

Despite this finding, Kentucky has cooperated in the development of RTOs in an effort to design a system in which restructured and non-restructured states can pursue their policy objectives simultaneously without interfering with each other's interests and welfare. As the Kentucky PSC concluded during its investigation of the adequacy of generation and transmission in Kentucky:

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between the Midwest ISO and the PJM Interconnection, L.L.C. , all of which are needed to increase market competition, not to serve bundled retail customers.

<sup>10</sup> "Findings and Recommendations Adopted by the Kentucky Special Task Force on Electricity Restructuring," issued December 13, 1999.

We support federal and other states' efforts to promote the benefits of competitive wholesale markets; moreover, we are aware that transmission systems not designed to serve the uses being contemplated must be transformed to resemble an interstate highway system if federal and other states' goals are to be achieved. Kentucky has achieved these same goals - low electric rates - under existing regulation, but we recognize that alternative approaches may work better elsewhere. We will do our best to cooperate with the federal government and other states to assist them in achieving their goals. Nevertheless, we cannot fulfill our duty to Kentucky customers by allowing them to help fund these efforts unless quantifiable benefits to those customers are clearly demonstrated.<sup>11</sup>

Consistent with this finding, the principle of cost causation demands that the costs of developing a robust wholesale market be borne by the participants in the wholesale market, not by bundled retail ratepayers. Kentucky's utilities have been able to use the existing regulatory framework, which contemplates sales of excess power through bilateral contracts, with great success. Wholesale market participants and customers in retail choice states must be financially responsible for supporting the development of the market designed to serve them.<sup>12</sup> However, previous FERC decisions on cost allocation favor spreading costs over a larger group of participants rather than just those who directly benefit. If success of competition hinges on socializing costs to customers who do not want it, have not asked for it, and do not benefit from it, then there is no reasonable justification for electricity restructuring.

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<sup>11</sup> See Kentucky Public Service Commission, Administrative Case No. 387, Final Order (December 20, 2001) at 9-10.

<sup>12</sup> Accordingly, an adder on each wholesale market transaction might be one way to collect these costs, rather than charging all customers, including retail customers, a transmission usage fee.

This principle of cost causation is also applicable to the issue of transmission expansions and upgrades. These projects must be participant funded, with those who directly benefit paying the costs.<sup>13</sup> We further discuss participant funding later in this document, and will more fully develop our concerns on this issue in subsequent comments to be filed in January 2003.

**IV. Absent a thorough cost benefit analysis demonstrating benefits to all, FERC should not implement standard market design.**

The SMD NOPR does not include an analysis of the net costs or benefits of the proposed rule. If there were clear and universal benefits to be gained from the SMD, it is unclear to the Kentucky PSC why that evidence would be excluded from the document. We can only assume from the absence of this evidence that FERC has conducted no analysis to identify and assess the impact of cost shifts and savings, if any, that will result from the provisions in the SMD NOPR.

The only cost analysis that has been conducted, to our knowledge, was that conducted by ICF Consulting in this docket earlier this year. This study, though represented as a “cost benefit study” of RTOs, seemed instead to be a study of the benefits of nationwide restructuring. The Kentucky PSC filed comments on the conclusions of this study, outlining our concerns.<sup>14</sup> We have yet to see a FERC response

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<sup>13</sup> The support of participant funding is viewed consistently among Kentucky energy policy makers as a necessary element to any attempt at developing a standard market design. Governor Paul Patton asserted this point strongly in his testimony to the United States Senate Committee on Energy and Natural Resources on September 17, 2002. Additionally, the Interim Joint Committee on Agriculture and Natural Resources of the Kentucky General Assembly asserted this point in a resolution passed unanimously on November 13, 2002. That resolution will be filed in this docket by the Joint Committee.

<sup>14</sup> See Comments of the Kentucky Public Service Commission, April 9, 2001 in FERC Docket No. RM01-12-000.

to these concerns. Absent clear benefits, implementing dramatic changes as suggested in the SMD NOPR would be contrary to this Commission's duty of ensuring that only prudently incurred costs are recovered from ratepayers.

Further, we fully support the language added to the House Appropriations bill in September 2002 that would require DOE to conduct a cost study of the SMD prior to implementation of the rule. It is critical that this study be conducted independently and that it reflect the full impact on individual states, not just broad regions of the country. The study should be completed and analyzed prior to any action as dramatic as that suggested by the proposed rules in question. As we stated before, the first goal of all regulation should be to do no harm. That goal cannot be reached unless FERC makes a conscious decision to ensure that any market design rules it adopts will not injure any of the states.

**V. The new congestion management system proposed in the SMD NOPR will be costly to implement, and may not preserve the vested rights of those who have paid for the existing systems.**

The SMD NOPR proposes the adoption of Locational Marginal Pricing ("LMP") as a means to allocate scarce transmission capacity to those who value it most. It is also designed to serve as an incentive system that encourages market participants to buy and sell power in a manner consistent with the reliable operation of the system.<sup>15</sup>

Under LMP, the cost of transmission congestion is expressed as the difference in generation costs between transmission nodes. This necessitates taking traditional firm

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<sup>15</sup> NOPR, Paragraph 210.

network service and breaking it down into a set of point-to-point rights, which FERC has called Congestion Revenue Rights. FERC then appears to propose a re-aggregation of point-to-point rights to form a new form of network service, called Network Access Service.

We have several concerns about this. First and foremost is the implementation cost. Significant work is required to convert existing firm transmission service into its equivalent under LMP. Indeed, it is probably impossible to accord everyone the same rights under LMP that they have today. Naturally, this is of concern to us.

Extensive man-hours are required to translate existing entitlements, both in terms of tariffed and contractual services, into a set of simultaneously feasible point-to-point rights. MISO recently filed a tariff<sup>16</sup> that would assign these costs to rights-holders. The Kentucky PSC strenuously objects to this proposed tariff, and has filed its protest in that docket.

The assignment of cost is a generic policy issue that should be resolved in this proceeding. For example, we do not believe that the “cost-causers” under the proposed MISO tariff are those who currently hold transmission rights and wish to retain those rights. The cost-causers are those who wish to develop a competitive marketplace from which they hope to benefit. We suspect that the main beneficiaries of this proposed tariff will be those who do not hold firm transmission rights today. We take no issue with that, but rather simply believe that a competitive marketplace should be financially self-sustaining and should not require subsidies from bundled retail load to be financially

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<sup>16</sup> See FERC Docket ER02-2595-000.

viable. Our retail customers should not be forced to pay for the questionable privilege of having their rights confiscated with only some portion of them returned.

We look forward with interest to seeing FERC's resolution of this extremely complex issue and its identification of the real cost-causers. The Kentucky PSC intends to file more detailed comments regarding this issue in January 2003.

**VI. Those who have paid the embedded cost of transmission should retain the right to use all of that transmission capacity.**

The allocation of transmission rights is very important to Kentucky. Those who have paid the embedded cost of transmission should retain the right to use all of that transmission capacity. Such retention of these rights will result in an equitable allocation as well as provision of proper incentives to build new transmission. If those who are required to pay for new construction are not accorded the rights to use it, why should they agree to build it?

As we noted in our previous comments on FERC's Options Paper,<sup>17</sup> establishing this as a logical goal also makes related allocation decisions, such as the question of who receives rights to any excess capacity, easier to decide. The correct answer to this question is – once again – that those who have paid the related embedded costs should receive the rights. To decide otherwise would provide no incentive to build extra capacity for growth in the future. Why pay to build something that will be taken away from you?

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<sup>17</sup> See Comments of the Kentucky Public Service Commission, April 10, 2002 in FERC Docket No. RM01-12-000.



This logic can also be applied to determining who should pay for transmission expansions. We strongly believe that the allocations for “old” and “new” transmission need to be consistent. This is in keeping with our previous assertion that those who benefit should pay, and conversely, that those who pay should benefit. We will submit further comment on these issues in January 2003.

**VII. FERC’s proposal for a federally mandated generation requirement is not only unlawful, it is bad regulatory policy, and it should be removed from the SMD NOPR.**

In the NOPR, FERC proposes a resource adequacy requirement “to help ensure development of the infrastructure needed for reliable transmission system operation.”<sup>18</sup> The proposal allows for regional flexibility, and even admits that the “traditional reserve margin requirement imposed by states on monopoly utilities” has “worked well during most of the last century to ensure adequate supplies.”<sup>19</sup>

In reality, there is no specific reserve margin mandated in Kentucky. We have never found a need to impose such a margin, since incentives exist to ensure adequate capacity. In addition, there is extensive oversight of each utility’s resource plans to ensure this is accomplished in a least-cost manner. Indeed, our incentives are so effective that we are just as concerned with over-building as with under-building, and rightfully so, considering that generation projects are tremendously capital-intensive.

In our view, specifying an arbitrary requirement is inferior to the more flexible approach we take in Kentucky, where we review each utility’s resource plans periodically

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<sup>18</sup> NOPR, Paragraph 460.

<sup>19</sup> NOPR, Paragraph 480.

with a more in-depth approval process for each individual project. Kentucky has the lowest electricity rates in the nation. We did not achieve that by specifying an arbitrary reserve requirement.

**VIII. The SMD NOPR would relegate the states to merely advisory roles, interfering with their exercise of the police power and depriving the general public of a meaningful voice.**

The NOPR makes brief mention of a new entity called a “Regional State Advisory Committee” (“RSAC”) to provide “a formal process for state representatives to engage” in dialogue with the RTO/ITP that controls the regional transmission grid. The purpose and powers of the RSAC are not sufficiently spelled out in the SMD NOPR, and the details that are provided raise more questions than they answer.

It appears that the RSAC may infringe upon, or even supplant in some instances, state authority over a number of functions, including resource adequacy, transmission planning and expansion, rate design and revenue requirements, demand response and load management. While we can see some value in sharing information regarding these functions with other states, a regional voice is not a substitute for necessary and proper state authority to protect Kentucky citizens. To the extent FERC intends the RSAC to supplant or diminish state authority over these functions, the Kentucky PSC is adamantly opposed to the RSAC. The Kentucky PSC would be in violation of its statutory mandate if it ceded authority to a regional body that is not accountable to Kentucky citizens.

We do not see any potential value in the RSAC concept as described in the SMD NOPR. A related concept that may merit more attention, that of Multi-State Entities

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(“MSE”), is mentioned briefly in the SMD NOPR. Although the National Governors’ Association document introducing the MSE concept is referenced in the SMD NOPR, we are unclear as to how the Commission views any interrelationship between the two, or whether one would necessarily obviate the need for the other.

The primary roles of the MSE include a number of responsibilities. The MSE will help to facilitate state coordination on transmission planning, certification, and siting at the regional level. It will also facilitate a strong state role in RTOs. MSEs will also establish an Interstate Protocol to coordinate the review and permitting of interstate transmission facilities, creating a one-stop application process for interstate lines and harmonizing to the extent possible all application procedures of relevant state and federal agencies. Additionally, the MSE will form project teams comprised of the affected states, (meaning the states affected by the interstate transmission projects proposed by the RTO plans). The project teams, by unanimous vote, should issue or deny a “Regional Need Finding” for all or part of the RTO plan. They will also coordinate multi-state review of proposed interstate transmission projects.<sup>20</sup> MSEs will promote voluntary cooperation and reduce the probability of an impasse among states utilizing regional negotiation and conflict resolution processes.

It is important to establish a meaningful role for MSEs in the operation and expansion of transmission systems without compromising existing state jurisdiction. The Kentucky PSC believes that a multi-state concept can and will work for the purposes identified by the NGA Task Force.<sup>21</sup>

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<sup>20</sup> State commissions should, of course, retain ultimate authority over utility construction and rate issues.

<sup>21</sup> Report of the NGA Task Force on Electricity Infrastructure, “Interstate Strategies for Transmission

We will submit further comments regarding RSACs and the related MSE concept in January 2003.

**IX. Any market monitoring mechanism must provide the monitor with meaningful authority, ensure independence, and actively involve state regulators.**

Critical to the development of a robust wholesale market is the implementation of a market monitor and strategies for mitigating market abuse. First, the market monitor must be independent - it must not be influenced by the interests or agenda of any particular market participant. Second, the market monitor should play an active role in the market design and planning process in order to prevent opportunities for market abuse from being incorporated in the design of the market. Third, the market monitor must be given the resources needed to monitor the energy markets. Accordingly, the monitor must have access to real time data. Fourth, the market monitors must be able to impose after-the-fact penalties, as well as mitigate market power abuses in real time so that market abusers never realize the benefits of their manipulative behavior, especially if reliability is threatened.

Finally, in addition to reporting to FERC's newly created markets oversight unit, the market monitor must report directly to state regulators. Traditionally, states have wielded substantial authority over utility conduct. In the event FERC is unable to check market abuse in a timely manner, states must be in a position to act to protect the interests of the regulated utility and its customers. Without information from the market monitor,

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Planning and Expansion," released July 15, 2002.

the states might not know when to act and what needs to be done. Furthermore, if the market monitor fails to act independently, informed state regulators will be aware, and will raise the matter for resolution.

**X. FERC lacks jurisdiction to implement large segments of the SMD NOPR.**

In the case upon which FERC largely bases its claim of jurisdiction, *New York v. Federal Energy Regulatory Comm’n*, \_\_\_ U.S. \_\_\_, 122 S.Ct. 1012 (2002), the Supreme Court did *not* hold that FERC has jurisdiction over the transmission component of bundled retail sales. Instead, the Court only “assumed for present purposes” that Enron had correctly so argued.<sup>22</sup> The Court went on to explain that “[I]t is obvious that a federal order claiming jurisdiction over *all* retail transmissions would have ... great... implications for the States’ regulation of retail sales – a state regulatory power recognized by the same statutory provision that authorizes FERC’s transmission jurisdiction.”<sup>23</sup> Nevertheless, it is upon this opinion that FERC has asserted the power, under Section 206 of the Federal Power Act, to remedy undue discrimination that allegedly exists in the retail market.

In addition to misplaced reliance upon *New York v. Federal Energy Regulatory Commission*, FERC has made two additional errors in its broad assumption of jurisdiction in the SMD NOPR. First, it has failed to take into account explicit limitations on FERC’s jurisdiction in other sections of the Federal Power Act. Second, it wholly ignores the logical impossibility of finding utility discrimination against *retail* competitors in areas where there is, by law, no retail competition.

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<sup>22</sup> Id.

FERC's jurisdiction ends where the states' explicit authority begins, and that authority begins at issues involving service reliability, generation, and facilities siting. *New York v. Federal Energy Regulatory Comm'n*, 122 S.Ct. at 1026 (citing with approval FERC's recognition in Order No. 888 that Congress left to the States authority to regulate generation and transmission siting, and noting FERC's refusal to intrude upon state jurisdiction concerning "local service issues, including reliability of local service; administration of integrated resource planning and utility buy-side and demand-side decisions"). In contrast to Order 888, which the Supreme Court upheld, the SMD NOPR intrudes into each of these areas.

The Federal Power Act, at Section 201(b), explicitly states that FERC has no jurisdiction over generating facilities; and Section 212(g) just as explicitly prohibits any FERC order that is inconsistent with state law governing retail marketing areas of electric utilities. The SMD NOPR does just that: it proposes direct preemption of at least one Kentucky statute,<sup>24</sup> and indirectly would at least partially preempt others.<sup>25</sup>

In addition, the Federal Power Act, at Sections 201(b), 202(b), and 207 clearly prohibits FERC from exercising jurisdiction over generation facilities, and Section 202(b) warns FERC that it may not require a utility to "sell or exchange energy when to do so

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<sup>23</sup> *Id.*

<sup>24</sup> KRS 278.214 Curtailment of service by utility or generation and transmission cooperative states "When a utility or generation and transmission cooperative engaged in the transmission of electricity experiences on its transmission facilities an emergency or other event that necessitates a curtailment or interruption of service, the utility or generation and transmission cooperative shall not curtail or interrupt retail electric service within its certified territory, or curtail or interrupt wholesale electric energy furnished to a member distribution cooperative for retail electric service within the cooperative's certified territory, except for customers who have agreed to receive interruptible service, until after service has been interrupted to all other customers whose interruption may relieve the emergency or other event." Under Kentucky law, preference for bundled retail customers is not undue discrimination; it is statutory policy.

would impair its ability to render adequate service to its customers.” The NOPR’s provisions requiring utilities to comply with an ITP’s orders to increase its generation or to purchase generation<sup>26</sup> violate the Federal Power Act. It also places a governmental responsibility in the hands of a private party and relegates the states, who should, pursuant to law, retain police power to protect their citizens, to a mere advisory role.

Next, the NOPR provides very little factual support for the proposition that “undue discrimination” exists in any retail market in the nation, citing “hot line calls” and “public conferences” as examples of “evidence” of such discrimination.<sup>27</sup> Certainly there is no finding that utilities in Kentucky have unduly discriminated against any competitor who wishes to “compete with vertically integrated utilities to serve load.”<sup>28</sup> No such competitors exist. No one other than Kentucky’s certified retail electric utilities is permitted by state law to “serve load.”<sup>29</sup> The reasoning behind the SMD NOPR indicates that Kentucky’s certified retail territory law, KRS 278.016, as well as its statute requiring utilities to give preference to native load, KRS 278.214, is somehow “discriminatory.” In proposing that such “discrimination” be remedied across the nation rather than in states that have allowed retail electricity competition, FERC apparently finds as much fault with state regulation such as Kentucky’s, despite its resounding success, as it does with alleged “discrimination” in competitive markets. FERC should limit remedies for

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<sup>25</sup> See, e.g., KRS 278.720 *et seq.* (giving to the Kentucky Board on Generation and Transmission Siting authority to issue a certificate for construction of non-PSC regulated generating plants and transmission lines).

<sup>26</sup> NOPR, Paragraphs 474, 475.

<sup>27</sup> NOPR, Paragraph 36. For all the text devoted to so-called “specific instances of undue discrimination and impediments to competition,” *see* NOPR at Paragraph 26, there is no systematic evaluation of discriminatory conduct. In addition to anecdotes and allegations, FERC offers Appendix C, which analyzes *hypothetical* opportunities for discrimination. This is not the stuff of thorough investigation.

<sup>28</sup> NOPR, Paragraph 36.

<sup>29</sup> KRS 278.016.

“discrimination” to those utilities that individually have been proven to “discriminate.” Kentucky’s have not.

Next, and perhaps the most troubling, the NOPR would give to a “regional” entity the authority to “require” each “load-serving entity” to “meet its share of the future regional need through a combination of generation and demand reduction.”<sup>30</sup> While the paragraph in which this startling announcement is made notes that “supply planning and retail customer demand response are the states’ responsibility,” it is impossible to reconcile that recognition with a provision that enables an entity that is entirely independent of state authority to “require” load-serving entities to plan and to construct in accordance with its findings. It is also supremely troubling to Kentucky that FERC would consider preempting states’ authority not in favor of the federal authority but instead in favor of a private entity that would not be politically answerable to the electricity-consuming public.

The Federal Power Act explicitly preserves the states’ authority over generation, as well as retail transactions; the Supreme Court has explicitly noted that states retain authority over siting and service reliability; and the Eight Circuit Court of Appeals has explicitly directed FERC not to interfere with states’ jurisdiction over transmission curtailment if it affects service reliability.<sup>31</sup> The SMD NOPR goes far beyond these limitations. Kentucky urges FERC to reconsider this attempt to usurp the lawful role of the states in electricity regulation.

## **CONCLUSION**

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<sup>30</sup> NOPR, Paragraph 14.

<sup>31</sup> *Northern States Power Co. v. Federal Energy Regulatory Comm’n*, 176 F.3d 1090 (8<sup>th</sup> Cir. 1999), *cert. Denied sub nom Enron Power Marketing, Inc. v. Northern States Power Co.*, 528 U.S. 1182 (2000).



The Kentucky PSC opposes any changes to the existing federal regulatory scheme that:

- have immediate and substantial adverse cost and reliability impacts on its citizens without commensurate benefits;
- would require our retail ratepayers to subsidize competitive markets;
- would effect a transfer of our regulatory authority over generation capacity to private entities, such as ITPs, who are not politically accountable to the general public; and
- would interfere with our duty and responsibility to ensure that their citizens receive adequate service for which they pay just and reasonable rates.

Unfortunately, these would be the results in Kentucky if the rules proposed in the SMD NOPR were implemented. Kentucky suggests that, if the NOPR is implemented, it be geographically limited to those states who have signaled that FERC's help in this regard is needed.

Respectfully Submitted,

Deborah T. Eversole, Esq.  
Richard Raff, Esq.  
Kentucky Public Service Commission  
211 Sower Boulevard  
P.O. Box 615  
Frankfort, KY 40601  
502-564-3940